

Memorandum

To: Honorable Jerome E. Horton, Chairman
Honorable Michelle Steel, Vice Chair
Honorable Betty T. Yee, First District
Senator George Runner, Second District
Honorable John Chiang, State Controller

Date: **August 9, 2011**

From: David J. Gau, Deputy Director
Property and Special Taxes Department

Subject: **Proposed Amendments to Cigarette and Tobacco Products Licensing Act Regulations**
(August 23, 2011 Business Taxes Committee Meeting Agenda)

The following item has been placed on the Board's August 23, 2011 Business Taxes Committee Meeting Agenda. Board Member Yee has requested that a discussion be held and a decision made on whether there is a need for rulemaking on this issue.

Business Taxes Committee

1. Proposed Amendments to Cigarette and Tobacco Products Licensing Act Regulations

Approval is sought to initiate an interested parties process to promulgate the proposed adoption of a new regulation and amendments to existing regulations under the Cigarette and Tobacco Products Licensing Act of 2003.

Attachment: Informal Issue Paper, "Proposed Amendments to Cigarette and Tobacco Products Licensing Act Regulations"

cc: Ms. Regina Evans
Mr. Louis Barnett
Mr. Alan LoFaso
Mr. Sean Wallentine
Ms. Marcy Jo Mandel
Ms. Kristine Cazadd, MIC 73
Mr. Randy Ferris, MIC 83
Ms. Lynn Bartolo, MIC 57
Ms. Diane Olson, MIC 80
Mr. Richard Parrott, MIC 88
Mr. Lou Feletto, MIC 31
Mr. Phillip Bishop, MIC 57

Approved: _____
Kristine Cazadd, Interim Executive Director

☐ For Information
☒ For Discussion
☒ For Decision Making

BOARD OF EQUALIZATION
INFORMAL ISSUE PAPER

Proposed Amendments to Cigarette and Tobacco Products Licensing Act Regulations

Issue

Whether the Board should initiate an interested parties process to promulgate the proposed adoption of a new regulation and amendments to existing regulations under the Cigarette and Tobacco Products Licensing Act of 2003.

Background

On October 12, 2003, the State of California enacted the Cigarette and Tobacco Products Licensing Act (Act) (Assembly Bill 71, Horton [Chapter 890, Statutes 2003]) (Act) which established a statewide licensing program under Division 8.6 (commencing with section 22970) of the California Business and Professions Code. The Act imposed licensing requirements on all retailers, wholesalers, and distributors of cigarettes and tobacco products and all manufacturers and importers of cigarettes. These licensing requirements are in addition to other permits and licenses that may be required depending on a person's business operations. The Act, intended to decrease tax evasion on the sales of cigarettes and tobacco products in California, also included provisions for new recordkeeping requirements, identified violations that may result in license suspensions and revocations and the imposition of civil and criminal penalties, in addition to providing Board staff with the authority to inspect and seize any untaxed cigarettes or tobacco products. Inspections are performed by the Board's Investigations Division and its findings may result in the issuance of citations and penalties for violations.

Discussion of the Issue

Whether the Board should initiate an interested parties process concerning the need for rulemaking to provide guidelines on the documentation and retention requirements for transfers of cigarette and tobacco products between retail stores owned by the same legal entity.

In addition, whether the Board should initiate an interested parties process to discuss proposed amendments to the following Cigarette and Tobacco Products Licensing Act Regulations: Regulation 4601, Service of a Notice of Violation or Warning Notice; Regulation 4603, Penalties for Licensed or Unlicensed Retailers; Regulation 4604, Penalties for Licensed or Unlicensed Wholesalers and Distributors; and Regulation 4605, Penalties for Licensed or Unlicensed Manufacturers and Importers.

The following provide synopses for a proposed new regulation and proposed amendments to four (4) existing regulations:

Proposed New Regulation

1. Transfers of Cigarette and Tobacco Products between Retail Stores Owned by the Same Person.

Based on several recent citations and related appeals proceedings involving the seizure of cigarette and tobacco products based on a retailer's failure to maintain proper documentation supporting the transfer of product from one licensed retail location to another licensed retail location owned by the same legal entity, the Special Taxes and Fees Division was asked to develop a new regulation to formalize the transfer of cigarette and tobacco products between licensed retail locations owned by the same legal entity. Transfers of cigarette and tobacco products between licensed retail locations owned by the same legal entity do not include sales of cigarette and tobacco products between licensed retail locations prohibited by Revenue and Taxation Code section 30478.

The proposed new regulation is consistent with current Board policy and procedures. In addition, in April 2011, Board staff provided guidance on these activities through an update to Publication 78, *Sales of Cigarettes and Tobacco Products in California* and a letter sent to legal entities owning multiple cigarette and tobacco products licensed retail locations.

A draft of the proposed new regulation is attached (Exhibit 1).

Proposed Amendments to existing Regulations

1. Regulation 4601, Service of Notice of Violation or Warning Notice

The Cigarette and Tobacco Products Licensing Act Law and Regulations do not provide formal guidance with regard to the service of a Notice of Suspension or Notice of Revocation. In April 2006, Regulation 4601 was adopted to provide guidance regarding the requirements for the proper service of a Notice of Violation or Warning Notice. Currently, Notices of Suspension and Notices of Revocation are issued in the same manner as required for the service of a Notice of Violation or Warning Notice. Staff believes formal regulatory guidance regarding the issuance of Notices of Suspension or Notices of Revocation should be placed within Regulation 4601. Accordingly, staff proposes to amend Regulation 4601 Service of Notice of Violation or Warning Notice to include Notices of Suspension and Notices of Revocation.

A draft of the proposed amendment to Regulation 4601 is attached (Exhibit 2).

2. Regulation 4603, Penalties for Licensed or Unlicensed Retailers.

Staff proposes initiating an interested parties process to discuss whether to amend Regulation 4603 subdivision (f) of the Act. In April 2006, Regulation 4603 was adopted to provide guidance regarding the assessment of penalties for a first offense of a violation and subsequent violations of the Act by a licensed or unlicensed retailer which would result in the issuance of a Warning Notice, suspension or revocation.

Regulation 4603 subdivision (f) provides that a reduction in the length of a suspension period may be warranted if mitigating circumstances are present as set forth in Regulation 4606. Currently, if a suspension period is reduced, the redetermined period of suspension can only be set at: 0 days, 10 days or 20 days. Staff believes that the authority to be more flexible in situations involving a reduction to the length of a suspension period may be helpful in its administration of the Act. For purposes of discussion, staff has drafted a proposed amendment to subdivision (f) that would allow flexibility in the redetermining of a suspension period within a range of zero (0) days to twenty (20) days. Proposed amendments also include the addition of Business and Profession Code sections involving violations that mandate the revocation of a retailer's license and the deletion of those sections whose violations do not apply to retailers.

A draft of the proposed amendment to Regulation 4603 is attached (Exhibit 3).

3. Regulation 4604, Penalties for Licensed or Unlicensed Wholesalers and Distributors.

Staff proposes initiating an interested parties process to discuss whether to amend Regulation 4604 subdivision (f) of the Act. In December 2006, Regulation 4604 was adopted to provide guidance regarding the assessment of penalties for a first offense of a violation and subsequent violations of the Act by licensed or unlicensed wholesalers and distributors which would result in the issuance of a Warning Notice, suspension or revocation.

Regulation 4604 subdivision (f) provides that a reduction in the length of a suspension period may be warranted if mitigating circumstances are present as set forth in Regulation 4606. Currently, if a suspension period is reduced, the redetermined period of suspension can only be set at: 0 days, 10 days or 20 days. Staff believes that the authority to be more flexible in situations involving a reduction to the length of a suspension period may be helpful in its administration of the Act. For purposes of discussion, staff has drafted a proposed amendment to subdivision (f) that would allow flexibility in the redetermining of a suspension period within a range of zero (0) days to twenty (20) days. Proposed amendments also include the addition of Business and Profession Code sections involving violations that mandate the revocation of a wholesaler's or distributor's license and the deletion of those sections whose violations do not apply to wholesalers or distributors.

A draft of the proposed amendment to Regulation 4604 is attached (Exhibit 4).

4. Regulation 4605, Penalties for Licensed or Unlicensed Manufacturers and Importers.

Staff proposes initiating an interested parties process to discuss whether to amend Regulation 4605 subdivision (e) of the Act. In December 2006, Regulation 4605 was adopted to provide guidance regarding the assessment of penalties for a first offense and subsequent violations of the Act by licensed or unlicensed manufacturers and importers which would result in the issuance of a Warning Notice, suspension or revocation.

Regulation 4605 subdivision (e) provides that a reduction in the length of a suspension period may be warranted if mitigating circumstances are present as set forth in Regulation 4606. Currently, if a

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suspension period is reduced, the redetermined period of suspension can only be set at: 0 days, 10 days or 20 days. Staff believes that the authority to be more flexible in situations involving a reduction to the length of a suspension period may be helpful in its administration of the Act. For purposes of discussion, staff has drafted a proposed amendment to subdivision (f) that would allow flexibility in the redetermining of a suspension period within a range of zero (0) days to twenty (20) days. Proposed amendments also include the addition of Business and Profession Code sections involving violations that mandate the revocation of a manufacturer's or importer's license and the deletion of those sections whose violations do not apply to manufacturers or importers.

A draft of the proposed amendment to Regulation 4605 is attached (Exhibit 5).

Other Sections

No Impact

Alternatives

Do not initiate an interested parties process.

Recommendation

Staff recommends that the Board initiate an interested parties process to allow the interested parties to discuss whether to amend the provisions of the Cigarette and Tobacco Products Licensing Act through promulgation of a new regulation and amendment of existing regulations, similar in content to the draft of regulations reflected in exhibits one (1) through five (5).

Critical Time Frames

None.

Preparation and Reviews

Prepared by Special Taxes and Fees Division, Property and Special Taxes Department.

Current as of: August 3, 2011

Informal Issue Paper

Regulatory Amendments to the Cigarette and Tobacco Products Licensing Act

Exhibits

Exhibit 1. Draft - Proposed new Regulation, Transfers of Cigarette and Tobacco Products between Retail Stores Owned by the Same Person

Exhibit 2. Draft - Proposed Amendments Regulation 4601, Service of Notice of Violation or Warning Notice

Exhibit 3. Draft - Proposed Amendments Regulation 4603, Penalties for Licensed or Unlicensed Retailers

Exhibit 4. Draft - Proposed Amendments Regulation 4604, Penalties for Licensed or Unlicensed Wholesalers and Distributors

Exhibit 5. Draft - Proposed Amendments Regulation 4605, Penalties for Licensed or Unlicensed Manufacturers and Importers

Exhibit 1

DRAFT – Proposed new Regulation XXXX
Transfers of Cigarette and Tobacco Products Between Retail Stores Owned by the Same Person.

Reference: Section 22971, 22974, 22974.3, and 22978.4, Business and Professions Code

(a) GENERAL. Every retailer of cigarette and tobacco products is required to maintain purchase invoices for all cigarettes and tobacco products purchased and make those invoices available for inspection by the board or a law enforcement agency. A licensed retailer owning multiple locations who wishes to transfer cigarette and tobacco product between its licensed locations shall prepare a transfer log or document at the time of transfer and maintain the records for four years from the date of transfer. A copy of the transfer log or document, accompanied by a copy of the original purchase invoice(s) documenting the purchase of each item transferred, must be kept at both the transferring and receiving locations involved in the transfer for at least one year after the transfer.

(b) SPECIFIC APPLICATION. The transfer log or document shall show the following:

- (1) the transferring retail location, license information, supplier's name, invoice number, and the date the bulk cigarette and tobacco product purchase was made;
- (2) the receiving retail location(s), license information, and date the cigarette and tobacco product was transferred; and,
- (3) a legible, readable, itemized listing of cigarette and tobacco product transferred including packaging (e.g., 20 5-packs; 60-ct boxes), flavor and/or style, and quantity transferred.

(c) The transfer of cigarette and tobacco product shall only be allowed when the legal entity licensed as the retailer for the retail location transferring the cigarette and tobacco product is the same legal entity that is licensed as the retailer at the retail location receiving the cigarette and tobacco product. As an example, a transfer between a location licensed as a sole proprietorship and a location licensed as a partnership where the sole proprietor is one of the partners would not qualify under this section, since the same legal entity does not own both locations.

(d) Records of the transfer shall be made available to the board or its authorized representative for examination upon request. Failure to provide such documentation when requested can result in the seizure of the cigarette or tobacco product that is claimed to be transferred and the issuance of a citation. Transfer logs or documents created or provided after a seizure and/or citation are not acceptable and cannot be used for the return of seized product or dismissal of a violation.

History: Adopted XXX

Exhibit 2

Proposed Amendments Regulation 4601, Service of Notice of Violation or Warning Notice

Reference: Sections 22974.7, 22978.7, 22979.7, Business and Professions Code.

The Notice of Suspension, Notice of Revocation, Notice of Violation or Warning Notice shall be placed in a sealed envelope, with postage paid, addressed to the licensee or unlicensed person at his or her last known address as it appears in the records of the Board. The giving of notice shall be deemed complete at the time of deposit of the notice at a United States Post Office, a mailbox, sub-post office, substation, mail chute, or other facility regularly maintained or provided by the United States Postal Service, without extension of time for any reason. In lieu of mailing, a ~~Notice of Violation~~ may be served personally by delivery to the person to be served and service shall be deemed complete at the time of such delivery. Personal delivery to a corporation may be made by delivery of a notice to any person designated to be served for the corporation with summons and complaint in a civil action, pursuant to the Code of Civil Procedure.

History: Adopted , effective .

Exhibit 3

Proposed Amendments Regulation 4603, Penalties for Licensed or Unlicensed Retailers

Reference: Sections 22973, subdivision (a)(5), 22974, 22974.3, 22974.4, 22974.7, 22980.1, subdivisions (c), (d), (e), (g), 22980, subdivision (b), 22980.2, subdivision (a), 22980.3, subdivisions (a)(2) (d), Business and Professions Code.

The following penalties shall be assessed in addition to any other civil or criminal penalty provided by law upon a finding that a retailer has violated any provision of the Act:

(a) A first offense of a violation of any of the following provisions shall result in the issuance of a Warning Notice to the licensee or unlicensed person:

(1) Business and Professions Code section 22974 (retailer's failure to retain purchase invoices).

(2) Business and Professions Code section 22980.1, subdivision (c), (d) or (e) (purchase from unlicensed person or person with suspended or revoked license).

(3) Business and Professions Code section 22980.1, subdivision (g) (purchase of cigarettes to which a stamp may not be affixed in accordance with Rev. & Tax. Code, § 30163, subd. (b)).

(4) Business and Professions Code section 22980.2 subdivision (a) (sales of cigarettes or tobacco products by an unlicensed person or person with suspended or revoked license).

(b) A first offense of a violation of any of the following provisions shall result in the issuance of a 20-day suspension:

(1) Business and Professions Code section 22973, subdivision (a)(5) (retailer's false statement on application).

(2) Business and Professions Code section 22980, subdivision (b) (any person's refusal to allow inspection).

(c) A second or subsequent offense for a violation of the provisions listed in subdivision (a) or (b) above, shall result in both a 30-day suspension or revocation and a fine. The fine shall be determined in accordance with Regulation 4607.

(d) A violation of Business and Profession Code section 22974.3 (possession of unstamped cigarettes or untaxed tobacco products) shall result in the following:

(1) Notwithstanding paragraphs (2) and (3) below, a Warning Notice for a first offense when the licensee has been in business for less than one month and there has been no purchase of new cigarette or tobacco product inventory during that period.

(2) A 10-day suspension for a first offense for a seizure of less than 20 packages of cigarettes, or the equivalent amount of tobacco products based on wholesale cost.

(3) A 20-day suspension for a first offense for a seizure of 20 packages of cigarettes or more, or the equivalent amount of tobacco products based on wholesale cost.

(4) Both a 30-day suspension or revocation and a fine for a second or subsequent offense. The fine shall be determined in accordance with Regulation 4607.

(e) In cases involving multiple violations, the violation punishable by the most severe penalty will be used for purposes of determining the penalty assessed.

(f) Notwithstanding subdivisions (b) through (e) above, a reduction in the length of a suspension period may be warranted if mitigating circumstances are present, as set forth in Regulation 4606. If any suspension period is reduced, the redetermined period of suspension shall be within a range of 0 days, 10 days, or to 20 days. The existence of mitigating circumstances may also warrant reducing a revocation penalty to a 30-day suspension, unless revocation is mandated pursuant to Business and Professions Code section 22974.3 subdivision (a)(2) or subdivision (a)(4), 22974.4, ~~22978.6~~, or 22980.3, subdivision (a)(2) or subdivision (d).

History: Adopted, effective.

Exhibit 4

Proposed Amendments Regulation 4604, Penalties for Licensed or Unlicensed Wholesalers and Distributors

Reference: Sections 22974.7, 22977, subdivision (a)(5), 22978.1, 22978.2, 22978.7, 22978.5, subdivision (b), 22979.7, 22980, subdivision (b), 22980.1, subdivisions (b), (c), (d), (e), (f), (g), 22980.2, subdivision (a), and 22980.3, subdivisions (a)(2)(d) Business and Professions Code.

The following penalties shall be assessed in addition to any other civil or criminal penalty provided by law upon a finding that a wholesaler or distributor has violated any provision of the Act:

(a) A first offense of a violation of any of the following provisions will result in the issuance of a Warning Notice to the licensee or unlicensed person:

(1) Business and Professions Code section 22978.1 (distributor's or wholesaler's failure to retain purchase invoices).

(2) Business and Professions Code section 22978.4, subdivision (c) (distributor's or wholesaler's failure to comply with invoice requirements).

(3) Business and Professions Code section 22978.5, subdivision (b) (distributor's or wholesaler's failure to retain sales records).

(4) Business and Professions Code section 22980.1, subdivision (b), (c), (d), (e) (sales to or purchases from unlicensed person or person with suspended or revoked license) or (f) (sales of cigarettes or tobacco products to retailer or wholesaler revoked or suspended until debts are clear).

(5) Business and Professions Code section 22980.2, subdivision (a) (sales of cigarettes or tobacco products by unlicensed person or person with suspended or revoked license).

(b) A first offense of a violation of any of the following provisions will result in the issuance of a 20-day suspension:

(1) Business and Professions Code section 22977, subdivision (a)(5) (distributor's or wholesaler's false statement on application).

(2) Business and Professions Code section 22980, subdivision (b) (any person's refusal to allow inspection).

(3) Business and Professions Code section 22980.1, subdivision (g) (purchase of cigarettes to which a stamp may not be affixed in accordance with Rev. & Tax. Code, § 30163, subd. (b)).

(c) A second or subsequent offense for a violation of the provisions listed in subdivision (a) or (b) above shall result in both a 30-day suspension or revocation, and a fine. The fine shall be determined in accordance with Regulation 4607.

(d) A violation of Business and Profession Code section 22978.2 (possession of counterfeit stamped cigarettes by distributors, unstamped cigarettes by wholesalers or untaxed tobacco products) shall result in the following:

(1) Notwithstanding paragraphs (2) and (3) below, a Warning Notice for a first offense when the licensee or unlicensed person has been in business for less than one month and there has been no purchase of new cigarette or tobacco product inventory during the month.

(2) A 10-day suspension for a first offense for a seizure of less than 20 packages of cigarettes, or the equivalent amount of tobacco products based on wholesale cost.

(3) A 20-day suspension for a first offense for a seizure of 20 packages of cigarettes or more, or the equivalent amount of tobacco products based on wholesale cost.

(4) Both a 30-day suspension or revocation and a fine for a second or subsequent offense. The fine will be determined in accordance with section 4607.

(e) In cases involving multiple violations, the violation punishable by the most severe penalty will be used for purposes of determining the penalty assessed.

(f) Notwithstanding subdivisions (b) through (e) above, a reduction in the length of a suspension period may be warranted if mitigating circumstances are present, as set forth in Regulation 4606. If any suspension period is reduced, the redetermined period of suspension shall be within a range of 0 days, 10 days, or to 20 days. The existence of mitigating circumstances may also warrant reducing a revocation penalty to a 30-day suspension, unless revocation is mandated pursuant to Business and Professions Code section 22974.4, 22978.2, subdivision (a)(2) or subdivision (a)(4), 22978.6, or 22980.3, subdivision (a)(2) or subdivision (d).

History: Adopted, effective.

Exhibit 5

Proposed Amendments Regulation 4605, Penalties for Licensed or Unlicensed Manufacturers and Importers

Reference: Sections 22974.7, 22978.7, 22979.4, 22979, subdivision (b)(1), 22979.5, subdivision (b), 22979.7, 22980.1, subdivisions (a), (e), (f), 22980.2, subdivision (a), 22979.6, subdivision (c), 22980.3 subdivision (a)(2) (d) Business and Professions Code.

The following penalties shall be assessed in addition to any other civil or criminal penalty provided by law upon a finding that a manufacturer or importer has violated any provision of the Act:

(a) A first offense of a violation of any of the following provisions will result in the issuance of a Warning Notice to the licensee or unlicensed person:

(1) Business and Professions Code section 22979.4 (importer's failure to retain purchase invoices on premises).

(2) Business and Professions Code section 22979, subdivision (b)(1) (participating manufacturer's false statement on certification to the Board).

(3) Business and Professions Code section 22979.5, subdivision (b) (manufacturer's or importer's failure to retain sales records on premises).

(5) Business and Professions Code section 22980.2, subdivision (a) (sales of cigarettes or tobacco products by unlicensed person or person with suspended or revoked license).

(6) Business and Professions Code section 22979.6, subdivision (c) (manufacturer's or importer's failure to comply with invoice requirements).

(b) A first offense of a violation of Business and Professions Code section 22980.1, subdivision (g) (purchase of cigarettes to which a stamp may not be affixed in accordance with Rev. & Tax. Code, § 30163, subd. (b)) shall result in a 20-day suspension.

(c) A second or subsequent offense for a violation of the provisions listed in subdivision (a) or (b) above shall result in both a 30-day suspension or revocation and a fine.

(d) In cases involving multiple violations, the violation punishable by the most severe penalty will be used for purposes of determining the penalty assessed.

(e) Notwithstanding subdivisions (b) through (d) above, a reduction in the length of a suspension period may be warranted if mitigating circumstances are present, as set forth in Regulation 4606. If any suspension period is reduced, the redetermined period of suspension shall be within a range of 0 days, 10 days or to 20 days. The existence of mitigating circumstances may also warrant reducing a revocation penalty to a 30-day suspension, unless revocation is mandated pursuant to Business and Professions Code section ~~22974.4, 22978.6, or~~ 22980.3, subdivision (a)(2) or subdivision(d).

History: Adopted , effective .